FILED
FEB 27 2003
OFFICE OF THE CLERK

No. 02-695

In the Supreme Court of the United States

MICHAEL FITZGERALD, TREASURER, STATE OF IOWA,
PETITIONER

v.

RACING ASSOCIATION OF CENTRAL IOWA, ET AL.

ON WRIT OF CERTIORARI
TO THE SUPREME COURT OF IOWA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

THEODORE B. OLSON
Solicitor General
Counsel of Record

EILEEN J. O'CONNOR
Assistant Attorney General

KENT L. JONES
Assistant to the Solicitor General

DAVID ENGLISH CARMACK
JUDITH A. HAGLEY
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Whether the State of Iowa can tax the revenue from slot machines at parimutuel racetracks and the revenue from all casino games on riverboats, including slot machines, at different rates without violating the Equal Protection Clause of the Fourteenth Amendment of the United States Constitution.

TABLE OF CONTENTS

	Page
Interest of the United States	1
Statement	2
Summary of argument	6
Argument:	
I. The Iowa legislation satisfies the rational-basis test for reviewing equal protection challenges to tax legislation	8
II. The decision of the Iowa Supreme Court misapplies the settled equal protection principles that this Court and other federal courts have applied in reviewing challenges to federal tax legislation	18
Conclusion	23

TABLE OF AUTHORITIES

Cases:

Allied Stores of Ohio, Inc. v. *Bowers*, 358 U.S. 522 (1959)	12, 13, 15
Barter v. *United States*, 550 F.2d 1239 (7th Cir. 1977), cert. denied, 434 U.S. 1012 (1978)	21
Bradley v. *City of Richmond*, 227 U.S. 477 (1913)	10
Carmichael v. *Southern Coal & Coke Co.*, 301 U.S. 495 (1937)	7, 10, 15, 19
Central State Univ. v. *American Ass'n of Univ. Professors*, 526 U.S. 124 (1999)	9
Chickasaw Nation v. *United States*, 534 U.S. 84 (2001)	22
City of Cleburne v. *Cleburne Living Ctr., Inc.*, 473 U.S. 432 (1985)	17
City of New Orleans v. *Dukes*, 427 U.S. 297 (1976)	14
FCC v. *Beach Communications, Inc.*, 508 U.S. 307 (1993)	8-9, 17

Cases—Continued: Page

First Nat'l Bank v. *United States*, 681 F.2d 534 (8th Cir. 1982) 21
Flint v. *Stone Tracy Co.*, 220 U.S. 107 (1911) 10, 19-20
F.S. Royster Guano Co. v. *Virginia*, 253 U.S. 412 (1920) 19
Grauvogel v. *Commissioner*, 768 F.2d 1087 (9th Cir. 1985) 20
Harris v. *McRae*, 448 U.S. 297 (1980) 19
Heckler v. *Mathews*, 465 U.S. 728 (1984) 14
Lehnhausen v. *Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973) 9
Mathews v. *De Castro*, 429 U.S. 181 (1976) 1
Mathews v. *Diaz*, 426 U.S. 67 (1976) 10
Mathews v. *Lucas*, 427 U.S. 495 (1976) 17
McGowan v. *Maryland*, 366 U.S. 420 (1961) 9, 15
Metropolitan Life Ins. Co. v. *Ward*, 470 U.S. 869 (1985) 13
Morrow, In re, 616 N.W.2d 544 (Iowa 2000) 5
Moritz v. *Commissioner*, 469 F.2d 466 (10th Cir. 1972), cert. denied, 412 U.S. 906 (1973) 21
Mostowy v. *United States*, 966 F.2d 668 (Fed. Cir. 1992) 20
Nordlinger v. *Hahn*, 505 U.S. 1 (1992) 8, 9, 14, 15, 17, 19
Ptasynski v. *United States*, 550 F. Supp. 549 (D. Wyo. 1982) 20
Regan v. *Taxation With Representation*, 461 U.S. 540 (1983) 1, 9, 19, 22
Richards v. *Commissioner*, 745 F.2d 524 (8th Cir. 1984) 21
State v. *Ceaser*, 585 N.W.2d 192 (Iowa 1998) 5
State Board v. *Jackson*, 283 U.S. 522 (1931) 10
Steward Mach. Co. v. *Davis*, 301 U.S. 548 (1937) 7, 10, 12-13
United States v. *Correll*, 389 U.S. 299 (1967) 19

Cases—Continued: Page

United States v. *Hammes*, 3 F.3d 1081 (7th Cir. 1993) 22
United States v. *Maryland Savings-Share Ins. Corp.*, 400 U.S. 4 (1970) 19
United States v. *Ptasynski*, 462 U.S. 74 (1983) 20
United States R.R. Ret. Bd. v. *Fritz*, 449 U.S. 166 (1980) 9, 10, 17
W. W. Cargill Co. v. *Minnesota*, 180 U.S. 452 (1901) 10
Wallers v. *United States*, 847 F.2d 1279 (7th Cir. 1988) 20
Weinberger v. *Wiesenfeld*, 420 U.S. 636 (1975) 1
Williams v. *Vermont*, 472 U.S. 14 (1985) 9, 18

Constitution and statutes:

U.S. Const.:
Art. I: 20
§ 8 (Uniformity Clause) 20
§ 8, Cl. 1 (Taxation Clause) 8, 18
Amend. V (Due Process Clause) 8, 18, 21, 22
Amend. XIV (Equal Protection Clause) ..... *passim*
Act of Oct. 4, 1976, Pub. L. No. 94-455, § 504, 90 Stat. 1563 21
Internal Revenue Code, 26 U.S.C. 1 *et seq.* 8, 18, 21, 22
26 U.S.C. 214 (1954) 21
26 U.S.C. 501(c) 19
26 U.S.C. 501(c)(14)(B) 19
26 U.S.C. 4401 21
26 U.S.C. 4401(a)(1) 21
26 U.S.C. 4401(a)(2) 21
26 U.S.C. 4402 22
26 U.S.C. 4421(2)(B) 22
Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 20

Statutes—Continued:	Page
Iowa Code Ann. (West 1996):	
§ 99D.15	3
§ 99D.15(2)	3
§ 99F.7(3)	11
§ 99F.11	3, 4
Miscellaneous:	
1 B. Bittker & L. Lokken, *Federal Taxation of Income, Estates, and Gifts* (3d ed. 1999)	21
W. Hellerstein, *State Taxation* (3d ed. 2001)	13

In the Supreme Court of the United States

No. 02-695

MICHAEL FITZGERALD, TREASURER, STATE OF IOWA, PETITIONER

v.

RACING ASSOCIATION OF CENTRAL IOWA, ET AL.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF IOWA

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

This case addresses whether a State violates the Equal Protection Clause of the Fourteenth Amendment of the Constitution by taxing different classes of taxpayers at different rates for similar, but not identical, activity. Although the Fourteenth Amendment does not apply directly to the United States, "[i]t is well settled that the Fifth Amendment's Due Process Clause encompasses equal protection principles." *Mathews* v. *De Castro*, 429 U.S. 181, 182 n.1 (1976). And, this Court has stated that its "approach to Fifth Amendment equal protection claims has always been precisely the same as to equal protection claims under the Fourteenth Amendment." *Weinberger* v. *Wiesenfeld*, 420 U.S. 636, 638 n.2 (1975). See *Regan* v. *Taxation With Representation*, 461 U.S. 540, 546-548 (1983). The United States therefore has a substantial interest

in the correct application of the constitutional principles addressed in this case.

STATEMENT

1. Iowa authorizes two separate types of gambling establishments: racetracks and excursion riverboats. Pet. App. 3. Respondents are operators and users of racetrack gambling facilities. *Id.* at 58.

a. The authorization and taxation of these two types of gambling establishments in Iowa have separate and distinct histories. Pet. App. 59. Parimutuel gambling at racetracks was first authorized in 1983. No other form of parimutuel gambling or any other type of gambling activity was permitted in Iowa at that time. *Ibid.* No limits were imposed on the amount of any bet or on any individual's total losses for parimutuel wagering at racetracks. *Id.* at 63 n.6. A state-formed Racing Commission was established to supervise racetrack activities, and only "qualified nonprofit corporations" were permitted to conduct parimutuel wagering at Iowa racetracks. *Id.* at 59.

b. Iowa first authorized casino and other gambling games on excursion riverboats in 1989. Pet. App. 62. Riverboats were allowed to offer a broad variety of casino games as well as video machine and slot machine games. *Id.* at 63. Riverboat operators were required to create and utilize riverboats that invoked Iowa's riverboat history. They were also required to utilize Iowa resources, goods, services, employees and entertainers. *Ibid.* The Iowa legislation enacted in 1989 limited the maximum wager on any single bet on a riverboat to five dollars and limited the maximum loss for any individual passenger on a riverboat excursion to two hundred dollars. *Ibid.*

c. Prior to 1994, Iowa applied different tax rates to the revenues received by these two separate types of gambling establishments. The highest tax rate applied to the revenue from parimutuel gambling on horse or dog races was six percent. Iowa Code Ann. § 99D.15 (West 1996). Racetracks, however, received a tax credit of up to five percent of the gross sum wagered per year. Iowa Code Ann. § 99D.15(2).

By contrast, the highest tax rate applied to the revenue from gambling on riverboat casinos was 20 percent. Iowa Code Ann. § 99F.11. And, unlike the racetrack industry, the riverboat industry received no tax credit for any portion of its revenues.

2. By 1994, both riverboat and racetrack gambling had encountered serious economic difficulties in Iowa. Pet. App. 66. Attendance at Iowa racetracks had significantly dwindled (*id.* at 61), and Iowa riverboat casinos had encountered stiff competition from riverboats from neighboring States (such as Illinois) that imposed no limits on the amounts that could be bet or lost by individual gamblers (*id.* at 65). As a consequence of this competition, half of the Iowa riverboat operators left Iowa during 1992 and 1993 to operate in States that had no bet or loss limits. *Id.* at 65-66; see Pet. 7.

These economic difficulties were detailed in a study that was commissioned by the Governor of Iowa to recommend changes in the Iowa gambling laws. In response to the recommendations of that study, Iowa enacted legislation in 1994 to improve the competitiveness of the Iowa riverboat and racetrack industries. Pet. App. 67-69. The legislation assisted racetracks by permitting them to operate slot machines (but not casino games or other video gambling games) at their facilities. *Id.* at 22, 69. The legislation assisted the

competitive position of riverboats by eliminating the wager and loss limits on individual gamblers. *Ibid.*

This 1994 legislation did not change the graduated tax of up to 20 percent imposed on the gambling receipts of riverboats. See Iowa Code Ann. § 99F.11 (West. 1996). It also did not alter the six percent excise tax on parimutuel betting at racetracks. It did, however, impose a graduated tax of up to 20 percent solely on *receipts from slot machines* at racetracks. It further provided that, beginning in 1997, this graduated tax rate for slot machine receipts at racetracks would increase by two percent a year until the maximum rate reached 36 percent. Pet. App. 22-23.[1]

3. Respondents brought suit in state court to challenge the constitutionality of the differential tax imposed on racetrack and riverboat gambling receipts. They argued that, by taxing gambling receipts at racetracks at a rate higher than similar receipts were taxed at riverboats, the Iowa statute violates the Equal Protection Clauses of the state and federal constitutions. Pet. App. 48-51.

The state district court rejected respondents' claim. Pet. App. 20-40. The court found several rational bases to uphold the constitutionality of the statute. In particular, the court concluded that the differential treatment of riverboat and racetrack gambling was rationally related to the State's legitimate interest in "promoting * * * river town development,"

[1] The Gambling Study Committee established by the Iowa Governor had recommended that, because "land-based casinos could function with a lower operating cost," the State should impose a higher excise tax on racetrack gambling than on riverboat gambling. Pet. App. 68. The Committee proposed a flat rate of 24 percent for racetrack gambling, compared to the highest rate of 20 percent for riverboat gambling. *Ibid.*

"preserving Iowa's riverboat history," preventing riverboat casinos from leaving the State and thereby preserving "a needed or useful industry." *Id.* at 34.

4. By a 4-3 vote, the Iowa Supreme Court reversed the district court and held the statute to be unconstitutional. Pet. App. 1-19.

a. The court acknowledged at the outset that there are "some differences * * * between the two gaming facilities." Pet. App. 7. The court held, however, that these differences are not "sufficiently compelling" to support application of different tax rules to the similar activities that they conduct. *Id.* at 8. The court concluded that the proffered rationale of the 1994 legislation—that it sought to improve the competitive position of riverboats and racetracks in Iowa—could not support the statute, because imposing a higher tax on racetracks would simply "drive the racetracks out of business." *Id.* at 14. The court emphasized that, in its view, a lower tax rate for riverboats was not the "only" way to promote Iowa's riverboat history and was not necessary to "make Iowa riverboats more competitive with other states." *Id.* at 15. Finding no rational basis for the difference in the tax treatment of riverboat and racetrack gambling, the court held that the higher tax rate imposed on racetrack gambling violates the Equal Protection Clause of both the United States and Iowa constitutions. *Id.* at 16.[2]

[2] The Iowa Supreme Court emphasized that it would follow its longstanding practice of applying "the same analysis in considering the state equal protection claims as . . . in considering the federal equal protection claim." Pet. App. 6 (quoting *In re Morrow*, 616 N.W. 2d 544, 547 (Iowa 2000) (quoting *State* v. *Ceaser*, 585 N.W. 2d 192, 196 (Iowa 1998))).

b. The dissenting judges concluded that there were several valid and rational bases for the difference in tax. They emphasized that "[r]iverboats are not the same as racetracks" but are instead "different enterprises" that "speak to different cultural traditions." Pet. App. 18. The dissent concluded that "there is no constitutional impediment to a legislature favoring diversity in cultural attractions for its citizens and tourists" and that a legislature could rationally determine that a "riverboat casino holds more romantic tourist appeal than a casino stuck in a dog track." *Id.* at 18. The dissent also noted that the advancement of riverboat gambling by a lower tax rate was a permissible method of preserving the State's river tradition and also took into account "a very pragmatic distinction between the two gambling venues" (*ibid.*):

> [R]iverboats are mobile, racetracks are not. If the economic climate turns unfavorable here, a riverboat merely unties its lines and sails elsewhere.

SUMMARY OF ARGUMENT

In a long line of equal protection decisions, this Court has emphasized that the economic and social policy choices embedded in tax legislation are not lightly to be disturbed. Legislative classifications that do not burden fundamental rights or discriminate against suspect classes must be upheld if they are rationally related to a legitimate governmental purpose. In taxation, even more than other fields, the Court has held that legislatures necessarily possess the greatest freedom in classification. If a legislature concludes that "the public interest is served" by a tax differential, "one business may be left untaxed and another taxed, in order to promote the one or to restrict or suppress the other."

Carmichael v. *Southern Coal & Coke Co.*, 301 U.S. 495, 512 (1937). A legislature does not violate the requirements of equal protection by adopting a regime that taxes one segment of an industry even while it exempts another "business closely akin thereto." *Steward Machine Co.* v. *Davis*, 301 U.S. 548, 584 (1937).

The Iowa Supreme Court erred by ignoring these settled rules and overturning the economic policy choices made by the Iowa legislature. The decision of the Iowa legislature to provide a lower tax rate on gambling games for its riverboat industry than for its racetrack industry is rationally related to several plausible legitimate purposes. The legislature could have concluded that, in view of a history of riverboat usage in Iowa, riverboat gambling offers a substantial attraction to a form of tourism that the State desires to promote. The legislature also could have concluded that riverboats—being more mobile than racetracks—could, in the face of financial hardship, more easily remove their business and employment opportunities to another State. The legislature also could have concluded that riverboats have a higher cost structure than racetracks and that a lower tax on riverboats is needed to allow them to remain competitive within the State. By dismissing these reasons, and by suggesting that a higher tax rate could not be applied to racetracks unless it were the "only" way to attain those goals, the Iowa Supreme Court improperly usurped the legislative function.

This Court has consistently held that the Equal Protection Clause does not impose a rigid rule of tax equalization and that singling out one particular class for taxation or exemption does not infringe the Constitution. The inconsistent analysis adopted by the Iowa Supreme Court would have startling consequences if it

were applied to federal taxation through the Fifth Amendment. The Internal Revenue Code contains numerous classifications that single out groups of taxpayers and particular economic activities for separate tax treatment. Such industry-specific revenue provisions reflect detailed policy choices made by Congress pursuant to its constitutional authority "To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States * * * ." U.S. Const. Art. I, § 8, Cl. 1.

Recognizing the primary constitutional role of Congress in determining and implementing social and tax policies, this Court has consistently held that the equal protection "standard is especially deferential in the context of classifications made by complex tax laws" and that legislatures must be given "large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Nordlinger* v. *Hahn*, 505 U.S. 1, 11 (1992). The Iowa Supreme Court failed to honor and apply these established principles in this case.

ARGUMENT

I. THE IOWA LEGISLATION SATISFIES THE RATIONAL-BASIS TEST FOR REVIEWING EQUAL PROTECTION CHALLENGES TO TAX LEGISLATION.

1. This Court has repeatedly stated that in "areas of social and economic policy, a statutory classification that neither proceeds along suspect lines nor infringes fundamental constitutional rights must be upheld against equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *FCC* v. *Beach*

Communications, Inc., 508 U.S. 307, 313 (1993). See *Central State University* v. *American Ass'n of University Professors*, 526 U.S. 124, 127-128 (1999) (per curiam) (summarily reversing lower court decision that conflicted with this Court's standards for rational-basis review of equal protection challenges). This "standard is especially deferential in the context of classifications made by complex tax laws." *Nordlinger* v. *Hahn*, 505 U.S. 1, 11 (1992). In structuring tax laws, legislatures are given "large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Williams* v. *Vermont*, 472 U.S. 14, 22 (1985)(quoting *Lehnhausen* v. *Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973)). See also *Regan* v. *Taxation with Representation*, 461 U.S. 540, 547 (1983) (a "broad latitude" exists for legislative tax classifications).

In applying this deferential standard, the legislature need not have "actually articulate[d] at any time the purpose or rationale supporting its classification." *Nordlinger* v. *Hahn*, 505 U.S. at 15. The rational or logical basis for a difference in treatment that satisfies equal protection inquiry need not be stated in the statute or in its legislative history. It is enough that the court can discern a plausible justification for the distinction. *McGowan* v. *Maryland*, 366 U.S. 420, 426 (1961). Once a plausible explanation for a difference in treatment is identified, judicial inquiry "is at an end." *United States R.R. Retirement Bd.* v. *Fritz*, 449 U.S. 166, 179 (1980). The task of classifying persons for favored or disfavored tax treatment "'inevitably requires that some persons who have an almost equally strong claim to favored treatment be placed on different sides of the line,' * * * and the fact that the line might have been drawn differently at some points

is a matter for legislative, rather than judicial, consideration." *Ibid.* (quoting *Mathews* v. *Diaz*, 426 U.S. 67, 83-84 (1976)).

It is well established by the decisions of this Court that, if a legislature could plausibly conclude that "the public interest is served" by a tax differential, "one business may be left untaxed and another taxed, in order to promote the one or to restrict or suppress the other." *Carmichael* v. *Southern Coal & Coke Co.*, 301 U.S. 495, 512 (1937). When there is a plausible public interest in promoting the activities of a specific industry, a legislature does not violate the requirements of equal protection by adopting a tax regime that favors or exempts that segment of industry even while it taxes another "business closely akin thereto." *Steward Machine Co.* v. *Davis*, 301 U.S. 548, 584 (1936).[3]

2. The Iowa Supreme Court erred by ignoring these settled principles and by overturning the economic policy choices made by the Iowa legislature. As the dissenting justices below correctly concluded, the decision of the Iowa legislature to provide a lower tax rate on casino and slot machine gambling for its river-

[3] The decisions of this Court make it "abundantly clear" that the differences required to support separate tax classifications "need not be great." *State Board* v. *Jackson*, 283 U.S. 522, 538 (1931) (citing cases). For example, in *W. W. Cargill Co.* v. *Minnesota*, 180 U.S. 452, 469 (1901), the Court upheld a state license fee imposed on proprietors of warehouses situated on railroad rights of way that was not applicable "to warehouses not so situated but doing exactly the same business." *State Board* v. *Jackson*, 283 U.S. at 538. See *Bradley* v. *City of Richmond*, 227 U.S. 477, 484-485 (1913) (upholding tax imposed on banks lending money secured by salaries at different rate than tax imposed on banks lending money on commercial securities); *Flint* v. *Stone Tracy Co.*, 220 U.S. 107, 158 (1911) (upholding tax that applied to corporations but not to partnerships or individuals conducting the same business).

boat industry than on slot machine games for its racetracks is rationally related to several plausible legitimate purposes.[4] Pet. App. 18; see also *id.* at 34.

"Riverboats are not the same as racetracks" but are instead "different enterprises" that "speak to different cultural traditions." Pet. App. 18 (Neuman, J., dissenting). The legislature could have concluded that, in view of a history of riverboat usage in Iowa, riverboat gambling offers a substantial attraction to a form of tourism that the State desires to promote. The advancement of riverboat gambling could also foster rivertown development and help preserve Iowa's riverboat history. See *id.* at 34. For example, the statute that authorizes riverboat gambling requires an applicant for a gambling boat license to "recreate boats that resemble Iowa's riverboat history." Iowa Code Ann. § 99F.7(3).

[4] It is factually imprecise to focus solely on these differential tax rates without also taking into consideration the separate revenue streams to which they apply. There are several ways in which gambling activities at riverboat and racetrack establishments in Iowa are treated differently. See pages 3-4, *supra*. In particular, Iowa provides certain tax benefits to racetracks (*i.e.*, a five percent tax credit and a lower tax rate on revenue from parimutuel gambling) that are not provided to riverboats. *Ibid.* Moreover, the tax on riverboats applies not only to revenues from slot machines but also to revenues from casino gambling (which is not permitted and thus not taxed at racetracks). There is thus no exactly parallel tax treatment of any particular stream of revenues at the two separate types of facilities. As we discuss in the text, however, even if that were not the case, and if Iowa simply taxed riverboats more leniently than it taxed racetracks on identical revenue streams, a preferential tax rate is permissible under the Equal Protection Clause for the reasons explained by the dissent in the Iowa Supreme Court and by the district court below. Pet. App. 18, 34.

Other rational justifications exist for this legislation. For example, the legislature could have concluded that because riverboats are more mobile than racetracks they could, in the face of financial hardship, more easily remove their business and employment opportunities to another State. See Pet. App. 34 (Newuman, J., dissenting) ("If the economic climate turns unfavorable here, a riverboat merely unties its lines and sails elsewhere."). Iowa, which had lost half of its excursion riverboats to other States by 1994, had a legitimate interest in enticing the remaining boats to stay. See page 3, *supra*. Moreover, as the State's Gambling Study Committee concluded, riverboats have a higher cost structure than racetracks and a lower tax on riverboats may be justified by the need to allow them to remain competitive within the State. See note 1, *supra*. As the district court explained in upholding the rational basis of this legislation, "the Iowa Legislature could have concluded that river boats should receive a beneficial tax rate because it is a needed or useful industry." Pet. App. 34.

This case therefore falls squarely within the ambit of the numerous decisions of this Court that have "repeatedly" held "that a statute which encourages the location within the State of needed and useful industries by exempting them, though not also others, from its taxes is not arbitrary and does not violate the Equal Protection Clause of the Fourteenth Amendment." *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 528 (1959) (citing cases). It is well established that a State does not violate the Constitution by adopting tax classifications that selectively encourage certain business activities even though other businesses "closely akin thereto" receive less favorable treatment. *Steward*

Machine Co. v. *Davis*, 301 U.S. at 584.[5] See W. Hellerstein, *State Taxation* ¶ 3.03, at 3-5 to 3-6 (3d ed. 2001); note 3, *supra*.

The State's separate tax treatment of revenues from riverboats and racetracks is also justified by the long line of cases that uphold the "grandfathering" of tax rates when new businesses are permitted to join a restricted or regulated industry. From 1989 to 1994, riverboats were the only facilities authorized to conduct casino gambling games (including slot machines) in Iowa, and they paid a maximum rate of 20 percent on revenues from such games. When the Iowa legislature authorized racetracks also to conduct slot machine gambling at racetracks in 1994, the State elected to tax this new entrant into that regulated industry at a maximum rate that began at 20 percent and grew over time to 36 percent. The State chose, however, to continue taxing riverboats at 20 percent in order to protect the riverboats' reliance on that preexisting tax rate. See pages 3-4, *supra*. This Court has clearly held that statutes that treat "existing vendors" differently from new entrants into a field of business do "not violate the Equal Protection Clause because [a legislature] 'could reasonably decide that newer businesses were less likely to have built up substantial reliance interests in

---

[5] Because Iowa riverboats and racetracks are both in-state industries, decisions rejecting state tax laws that seek to impose a preferential tax regime that favors domestic over foreign businesses are inapposite. See *Metropolitan Life Ins. Co.* v. *Ward*, 470 U.S. 869, 876-883 (1985) (disparate excise taxes for residents and nonresidents violate the Equal Protection Clause if they are designed to favor local residents); *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. 522, 527-530 (1959) (disparate taxes for residents and nonresidents do not violate the Equal Protection Clause if they promote local development by favoring nonresidents).

continued operation.'" *Nordlinger* v. *Hahn*, 505 U.S. at 14 (quoting *City of New Orleans* v. *Dukes*, 427 U.S. 297, 305 (1976)). Such "grandfathering" classifications in tax statutes "serv[e] to protect legitimate expectation and reliance interests [and] do not deny equal protection of the laws." 505 U.S. at 13-14 (citing cases).[6]

3. Any of these reasons is sufficient under this Court's decisions for the Iowa tax classifications to withstand an Equal Protection Clause challenge. By dismissing these plausible explanations for the legislative tax classifications, and by suggesting that a higher tax rate could not be applied to racetracks unless it were the "only" way to attain those goals (Pet. App. 15), the Iowa Supreme Court improperly usurped the legislative function.

In dismissing the several plausible justifications for the State's tax regime advanced by the dissenting judges, the Iowa Supreme Court focused on the fact that a widely understood general purpose of the 1994 legislation was to alleviate economic difficulties at both racetracks and riverboat casinos. The court's assumptions that the State's differential tax rates (i) must be justified by that single purpose (Pet. App. 11) and (ii) are inconsistent with that purpose (*id.* at 13-14), however, are both unfounded.

a. This Court has made clear that "the Equal Protection Clause does not demand for purposes of rational-basis review that a legislature or governing decision-

[6] In upholding a "grandfathering" provision in a state tax regime in *Nordlinger*, the Court noted that "[t]he protection of reasonable reliance interests is not only a legitimate governmental objective: it provides an exceedingly persuasive justification . . . ." 505 U.S. at 13 (quoting *Heckler* v. *Mathews*, 465 U.S. 728, 746 (1984)).

maker actually articulate at any time the purpose or rationale supporting its classification." *Nordlinger* v. *Hahn*, 505 U.S. at 15. It is only necessary that the plausible justifications for the state tax scheme "may conceivably" or "may reasonably" have been the purpose and policy of the legislature. *Ibid.* See *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. at 528-529. It is enough that a court can discern a plausible justification for the statute; that rationale need not be expressed in the text or history of the statute. *McGowan* v. *Maryland*, 366 U.S. at 426 (citing cases).

The court below erred by limiting its rational-basis inquiry to the specific "asserted purpose behind this tax" of "sav[ing] the racetracks and riverboats from financial distress." Pet. App. 10. Many other plausible justifications for the State's tax regime exist that are separate from and not inconsistent with that "asserted purpose." See pages 11-14, *supra*.[7] As this Court has made clear, a "legislature is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is *any conceivable state of facts which would support it.*" *Carmichael* v. *Southern Coal & Coke Co.*, 301 U.S. at 509 (emphasis added).

b. The court below further erred in concluding that the "differential tax completely defeats" the asserted purpose of "sav[ing] the racetracks and riverboats from financial distress" and "frustrates the racetracks'

[7] Here, as in *Nordlinger*, this is not a case in which the asserted general justifications for the 1994 legislation "left no room to conceive of any other purpose" for the Iowa tax regime. 505 U.S. at 16 n.7 (quoting *Allied Stores of Ohio, Inc.* v. *Bowers*, 358 U.S. at 530).

ability to contribute to the overall economy of this state." Pet. App. 10, 13, 15. The court asserted that requiring racetracks to "pay drastically more additional tax than riverboats are required to pay" would not "save the racetracks from economic distress" but would, instead, threaten "to drive the racetracks out of business, thereby helping the riverboat industry." *Id.* at 13-14.

That reasoning, however, is factually imperceptive and legally inapposite. The court ignored the fact that the same 1994 legislation that imposed the differential tax rates also, for the first time, authorized racetracks to operate slot machines in that State. The court's finding that the "differential tax completely defeats" the purpose of saving the racetracks from economic distress (Pet. App. 15) simply fails to consider that, without the 1994 legislation, racetracks would not have been permitted to operate slot machines *at all*. The differential tax is thus imposed on revenue that, but for the 1994 legislation, racetracks would not have been able to receive. It is obvious that Iowa racetracks are financially better off operating slot machines at a 36 percent tax rate than not operating slot machines at all—otherwise, they would simply elect *not* to operate slot machines. And, the record of this case reflects that, notwithstanding the differential tax rates in Iowa, the vast bulk of the revenue currently received by racetracks comes from slot machine gambling and not from parimutuel racing.[8] Pet. App. 8-9 & n.3.

Even if the 1994 legislation had *not* been effective in aiding the commercial fortunes of both riverboats and

[8] This is so even though parimutel racing is taxed at a lower rate than the rate that applies to gaming revenues at both racetracks and riverboats. See note 4, *supra*.

racetracks, however, that would not be grounds for invalidating the legislation. For purposes of equal protection review, the question is whether it is "plausible" that this legislation was enacted to attain that purpose. *Nordlinger* v. *Hahn*, 505 U.S. at 11. It is certainly plausible that the legislature thought that the racetracks would be better off with some slot-machine proceeds than with none at all.

The Iowa Supreme Court's related assertion that the legislature's tax classification was invalid because it was not the "only" (Pet. App. 15) way to attain its goals fundamentally misperceives the nature of rational-basis review. It is not a court's function to "hypothesize independently on the desirability or feasibility of any possible alternative[s]" to the statutory classification scheme. *Mathews* v. *Lucas*, 427 U.S. 495, 515 (1976). "These matters of practical judgment and empirical calculation are for [the legislature]." *Ibid.* When economic legislation is at issue, "the Constitution presumes that even improvident decisions will eventually be rectified by the democratic process." *City of Cleburne* v. *Cleburne Living Ctr., Inc.*, 473 U.S. 432, 440 (1985).

Line-drawing is an unavoidable component of the legislative process, and it "inevitably requires that some persons who have an almost equally strong claim to favored treatment be placed on different sides of the line." *United States R.R. Retirement Bd.* v. *Fritz*, 449 U.S. at 179. Although the economic choice embedded in specific tax classification provisions may seem unwise, unfair, or illogical, under rational-basis review, a court is not to "judge the wisdom, fairness, or logic of legislative choices." *FCC* v. *Beach Communications*, 508 U.S. at 313. This Court has made clear that legislatures are entitled to "large leeway in making classifications and drawing lines which in *their* judgment produce

reasonable systems of taxation." *Williams* v. *Vermont*, 472 U.S. at 22 (emphasis added). The court below thus seriously erred by substituting its judgment about effective economic policy for that of the legislature.

II. THE DECISION OF THE IOWA SUPREME COURT MISAPPLIES THE SETTLED EQUAL PROTECTION PRINCIPLES THAT THIS COURT AND OTHER FEDERAL COURTS HAVE APPLIED IN REVIEWING CHALLENGES TO FEDERAL TAX LEGISLATION.

This Court has consistently held that the Equal Protection Clause does not impose a rigid rule of tax equalization and that singling out one particular class for taxation or exemption does not infringe the Constitution. The inconsistent analysis adopted by the Iowa Supreme Court would have startling consequences if it were applied to federal taxation through the Fifth Amendment.

The Internal Revenue Code contains numerous classifications that single out groups of taxpayers and particular economic activities for separate tax treatment. Such industry-specific and taxpayer-specific revenue provisions reflect detailed policy choices made by Congress pursuant to its constitutional authority "To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States * * * ." U.S. Const. Art. I, § 8, Cl. 1. Recognizing the primary constitutional role of Congress in determining and implementing social and tax policies, this Court has consistently held that Congress has "a large area of discretion" to formulate "sound tax policies" and is entitled to an "especially broad latitude in creating classifications and distinctions in tax statutes." *Regan* v. *Taxation With Representation*, 461 U.S. at 547-548.[9]

Because of the "limitless factual variations" of American commerce (*United States* v. *Correll*, 389 U.S. 299, 307 (1967)), Congress is routinely required to draw lines and adopt classifications in tax legislation that allow some persons (and not others) advantages through exemptions, deductions, transitional rules, and tax rates. The legislative allowance of such preferences and distinctions is an indispensable part of effective tax legislation and Congress therefore has been given "the greatest freedom in classification." *Harris* v. *McRae*, 448 U.S. 297, 322 (1980).

Numerous decisions of this Court have applied that basic principle in upholding a wide variety of specific federal tax distinctions against equal protection challenges. See, *e.g.*, *Regan* v. *Taxation with Representation*, 461 U.S. at 550 (rejecting an equal protection challenge to 26 U.S.C. 501(c), which subsidized lobbying by veterans organizations but not other charities); *United States* v. *Maryland Savings-Share Ins. Corp.*, 400 U.S. 4, 6 (1970) (per curiam) (rejecting equal protection challenge to 26 U.S.C. 501(c)(14)(B), which contained a "grandfather clause" that exempted only insurers organized before a certain date); *Carmichael* v. *Southern Coal & Coke Co.*, 301 U.S. at 509 (rejecting an equal protection challenge to a federal unemployment tax that applied to some, but not all, employers); *Flint* v. *Stone Tracy Co.*, 220 U.S. at 158 (rejecting an

---

[9] "For purposes of rational-basis review, the 'latitude of discretion is notably wide in . . . the granting of partial or total exemptions upon grounds of policy.'" *Nordlinger* v. *Hahn*, 505 U.S. at 17 (quoting *F.S. Royster Guano Co.* v. *Virginia*, 253 U.S. 412, 415 (1920)).

equal protection challenge to a tax that applied to corporations but not to partnerships or individuals conducting the same business).[10]

The courts of appeals have also routinely applied these same principles in upholding specific classification provisions in federal tax legislation against equal protection challenges. See *Mostowy* v. *United States*, 966 F.2d 668, 672 (Fed. Cir. 1992) (rejecting equal protection challenge to transition rules of Tax Reform Act of 1986 that preserved the benefits of various prior deductions and exemptions only for certain taxpayers); *Wallers* v. *United States*, 847 F.2d 1279, 1282-1283 (7th Cir. 1988) (rejecting equal protection challenge to a "differential tax treatment" of railroad retirement benefits even though that treatment may not have been the "best" way to attain the legislative goal); *Grauvogel* v. *Commissioner*, 768 F.2d 1087, 1088-1090 (9th Cir. 1985) (rejecting equal protection challenge to a tax exemption that applied to federal employees but not to "similarly situated" state employees); *Richards* v.

[10] In *United States* v. *Ptasynski*, 462 U.S. 74 (1983), the Court held that, even under the more rigorous analysis required under the Uniformity Clause of Article I, Section 8 of the Constitution (which generally requires that "an excise tax apply, at the same rate, in all portions of the United States where the subject of the tax is found," *id.* at 84), Congress could properly exempt the production of crude oil from the North Slope of Alaska from the crude oil windfall profit tax that was imposed on the production of crude oil at all other locations within the United States. The Court concluded that, in light of the peculiar economic conditions attendant to oil production in northern Alaska, Congress could appropriately view oil from that region as an economic, not geographic, object of legislation. *Id.* at 85-86. The Court in *Ptasynski* did not address the equal protection challenge to that legislation that had been rejected in the district court in that case (*Ptasynski* v. *United States*, 550 F. Supp. 549, 555 (D. Wyo. 1982)).

Commissioner, 745 F.2d 524, 526 (8th Cir. 1984) (rejecting equal protection challenge to "favorable treatment" accorded to taxpayers who received pension benefits from a public, rather than private, system); *First National Bank* v. *United States*, 681 F.2d 534, 541 n.5 (8th Cir. 1982) (rejecting equal protection challenge to a benefit provided to bequests to church-owned cemeteries); *Barter* v. *United States*, 550 F.2d 1239, 1240 (7th Cir. 1977) (per curiam) (rejecting equal protection challenge to different tax rates for married couples and single individuals and stating that "perfect equality or absolute logical consistency between persons subject to the Internal Revenue Code [is not] a constitutional sine qua non").[11]

In the portion of the Internal Revenue Code that most closely relates to the subject of this case, Congress (like Iowa) has provided different tax rules for different types of gambling activities. For example, Section 4401 of the Code imposes a different rate of tax on revenues from legal and illegal gambling. See 26 U.S.C. 4401(a)(1) (tax of 0.25% on wagers authorized by state law); 26 U.S.C. 4401(a)(2) (tax of 2% on wagers not authorized by state law). Congress has also exempted

[11] We are aware of only one instance in which a classification in a federal tax law has been found to violate the Due Process Clause. In *Moritz* v. *Commissioner*, 469 F.2d 466 (10th Cir. 1972), the court held that 26 U.S.C. 214 (1954), which granted a deduction to women who have never married but not to similarly situated men, was subject to heightened scrutiny review and violated the Due Process Clause. Shortly after that decision was entered, that statute was repealed. Pub. L. No. 94-455, § 504, 90 Stat. 1563. We are not aware of any decision not later reversed on appeal that has held a federal tax classification invalid under the rational-basis standard of review. See 1 B. Bittker & L. Lokken, *Federal Taxation of Income, Estates, and Gifts* ¶ 1.2.5, at 1-28 (3d ed. 1999).

certain forms of gambling from taxation (26 U.S.C. 4402) and has exempted certain organizations from gambling taxes that other organizations that conduct identical gambling activity must pay (26 U.S.C. 4421(2)(B)). See also *Chickasaw Nation* v. *United States*, 534 U.S. 84 (2001). The assertion that the classifications contained in the federal gambling tax provisions deny equal protection to taxpayers has consistently been rejected by the courts. See *United States* v. *Hammes*, 3 F.3d 1081, 1082-1083 (7th Cir. 1993).

These statutory classifications fall well within the "especially broad latitude" of discretion that this Court has properly recognized as an indispensable feature in the formulation of a national tax policy. *Regan* v. *Taxation with Representation*, 461 U.S. at 547. The decision of the Iowa Supreme Court in this case, however, radically departs from these established principles. If adopted by this Court and applied to the federal government through the Fifth Amendment, the rationale applied by the Iowa court would produce extraordinary and unmanageable consequences. It would call into question the validity of numerous provisions in the Internal Revenue Code and would seriously impair the ability of Congress to formulate and implement flexible and sensible social, economic and tax policies in the future.

CONCLUSION

The judgment of the Supreme Court of Iowa should be reversed.

Respectfully submitted.

THEODORE B. OLSON
Solicitor General

EILEEN J. O'CONNOR
Assistant Attorney General

KENT L. JONES
Assistant to the Solicitor General

DAVID ENGLISH CARMACK
JUDITH A. HAGLEY
Attorneys

MARCH 2003